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DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

Colombian Economic Trends And Prospects

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CENTRAL INTELLIGENCE AGENCY
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INTELLIGENCE MEMORANDUM

Colombian Economic Trends And Prospects

Introduction

In its problems and accomplishments, the Colombian economy has long typified average Latin American experience. It has both avoided the rampant inflation and sluggish output growth of some countries and fallen far short of the impressive performance of Mexico and Panama. Certain developments at times promised accelerated progress: the formation of the National Front in 1958 (which allowed the Liberals and Conservatives to share power instead of shedding each other's blood), increased foreign aid in the 1960s, and the strong leadership of President Carlos Lleras Restrepo during 1966-70. Some moderate advances were made during Lleras' term, but these will be difficult to sustain under the Pastrana government, which began its four-year term (the last under the National Front) in August 1970. This memorandum reviews economic trends under Lleras and assesses the outlook under Pastrana.

Background

1. In most respects, conditions for Colombian economic development are simply representative of Latin America rather than distinctively good or bad. The population of 22 million people is the region's fourth largest, but the domestic market is limited by widespread subsistence agriculture

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and poor transport connections in the mountainous, heavily settled western area. Substantial land, mineral, forest, and hydroelectric resources await development, when capital becomes available. As in many other less developed countries, heavy dependence on one export -- in this case, coffee -- has periodically impeded economic growth. Beginning in the late 1940s, petroleum production reduced dependence on coffee, but oil exports have declined since 1965 because of diminishing reserves and growing domestic consumption.

2. Spurred by booming coffee exports, the economy grew an average of 5½% annually during the early 1950s despite disruptions caused by rural warfare between Liberal and Conservative party supporters.* The economic growth rate dropped in the mid-1950s to about 4%, however, when sagging prices greatly reduced coffee export earnings. In 1958, political violence in the countryside was ended -- and the investment climate improved -- by formation of the National Front, under which the two parties agreed to alternate the presidency and share other high government posts for 16 years. Under the Liberal administration of Alberto Lleras Camargo (1958-62), the political situation became more stable and economic growth accelerated, but excessive government spending generated large deficits.

3. Although the administration of Conservative President Valencia (1962-66) strengthened the budget substantially by curbing spending and enacting new taxes, economic performance deteriorated in other respects. Growth slowed, and inflation accelerated because currency devaluation in 1962 set off a wage-price spiral. In 1966 the cost of living rose 20% and a balance-of-payments crisis developed, principally as a result of expanded central bank credit to commercial banks and the semi-official Coffee Federation, which incurred a large deficit. In the wake of Bogota's financial ineptitude, the United States and the International Monetary Fund suspended assistance shortly after Valencia left office in August 1966.

* *This warfare, which followed a 1948 riot in Bogota set off by the assassination of populist leader Jorge Gaitan, lasted approximately ten years and caused more than 100,000 deaths.*

4. Despite the slowdowns during 1951-66, economic growth averaged 4.7% annually, approximating the regional average. But with population rising 3.2% annually, this growth rate yielded below-average per capita gains. In 1966, per capita gross domestic product (GDP) was about one-fifth below the regional average. Colombia's average rate of fixed investment continued to be somewhat below that for the region, and unemployment was severe in urban areas, where migration from the countryside had pushed population growth to about 5% annually.

Trends Under the Lleras Government

Policy Orientation

5. As a Liberal Party leader, Lleras Restrepo favored a larger, more positive economic role for the government than it played under the preceding administration. He intended to stimulate and guide development by channeling a growing share of income to the state and by initiating or accelerating various programs. The difference in viewpoint was not pronounced, however; both parties' philosophies reflect the oligarchy's continued political power and the fact that Colombia remains one of South America's more conservative, tradition-minded societies. Coming from the small upper class and one of the nation's most influential families (President Lleras Camargo was his cousin), the new President believed firmly that a strong capitalist economy could benefit all and that reform should be gradual. In any case, Lleras' freedom of action was circumscribed by increasing factionalism in the Congress and the requirement (finally dropped in 1968) that legislation be passed by a two-thirds majority.

6. On the whole, then, Lleras' economic approach was remedial and development-oriented rather than reformist. Although aware of pressing problems arising from unemployment and rapid urbanization, the government chose to allocate most resources toward production increases, taking the traditional view that some benefits eventually would filter down to everyone. One of Lleras' first measures was an orthodox financial stabilization program, similar in most respects to those

of the Argentine and Brazilian military governments. Another primary aim was to build up Colombian financial resources by maximizing capital inflows from both official and private sources. The government moved quickly to get more aid from US and international lending agencies and, in late 1967, settled its dispute with foreign oil companies over exchange rates, taxation, and exploitation rights.

Public Finance and Wage Control

7. Aided by substantial foreign capital inflows, the Lleras administration was able to pursue expansionary budget policies while holding inflation at a tolerable level. Central government spending (in real terms) rose an average of 11% annually during 1967-69, or about twice as fast as gross domestic product. Much of the upswing reflected investment outlays, which jumped from 31% to 38% of total spending. Transfers to several investment funds, decentralized agencies, and local governments -- largely for investment in agriculture, petroleum, and electric power -- and direct outlays on transport facilities accounted for most investment spending. The administration raised spending on social welfare facilities far above the depressed 1966 level, to about one-tenth of central government investment in 1969.

8. The government boosted its revenues (in real terms) almost twice as fast as national output with the aid of improved income tax collection and a new gasoline tax. Even so, the budget moved from a small surplus in 1966 to a deficit equaling 8% of expenditures in 1969. Nearly all the deficit was financed by foreign aid. The government also strengthened finances elsewhere in the public sector. For example, by relating coffee support prices more closely to export proceeds, it helped the Coffee Federation to become self-financing and even moderately reduce the Federation's debt to the central bank.

9. Financial stabilization also was aided by more effective government control of central bank credit expansion. Higher real interest rates and growing confidence in the economy stimulated the savings inflow, but the central bank kept credit expansion within bounds by withdrawing funds from

the commercial banking system. Furthermore, the Lleras regime -- more than previous administrations -- intervened in wage negotiations and had considerable success in keeping real wage increases in line with productivity gains.

Agricultural and Industrial Development

10. Agriculture did well under Lleras as a result of constructive government programs and a four-year run of favorable weather. The principal policy stimulant was increased support prices for most leading export crops. Also helpful were a large expansion in credit (especially to small and medium-sized farms), broadened extension services, public investments in farm-to-market roads and irrigation and storage facilities, and continued colonization efforts. Agricultural improvement was strongly supported by foreign aid, including loans from the United States, the World Bank, and the Inter-American Development Bank. All these factors combined to yield an average annual growth in output of 5½% in 1967-69, whereas the gain in 1961-66 (3% annually) merely matched population growth. The gains were mainly in export crops -- cotton, sugar, bananas, and soybeans; production of several domestic food crops stagnated (see Table 1).

11. After falling to only 3½% in 1967 because of severe import restrictions, the industrial growth rate improved markedly, averaging nearly 7% during 1967-69 compared with 6% in 1961-66. Opening the trans-Andean pipeline in early 1969 permitted exploitation of the Putumayo oil deposit and brought a resurgence in output. In manufacturing, one of the more dynamic industries was chemicals; new plants producing petrochemicals, synthetic fibers, and fertilizers helped to boost the industry's growth rate to an estimated 10% to 15% annually in 1968-69. The government fostered industrial expansion by strengthening investment and export incentives, liberalizing imports, opposing excessive wage demands, and making more credit available.

Table 1

Colombia: Agricultural Production

	Annual Average 1958-60	1966	1967	1968	1969
Index of agricultural output (value-added)	100	118	123	132	139
	Thousand Metric Tons				
Output of selected products					
Cotton	50	75	93	117	139
Raw sugar	N.A.	499	555	663	709
Bananas (export quality)	181	311	326	402	414
Soybeans	Negl.	52	56	71	140
Corn	849	895	950	825	900
Rice	433	542	662	786	670
Potatoes	679	832	900	950	850

Foreign Trade and Payments

12. Foreign exchange reforms, other export incentives, and rising coffee prices and foreign aid inflows strengthened the balance of payments during Lleras' term. In March 1967 the government adopted a "crawling peg" exchange rate system* to discourage speculative capital movements, make nontraditional exports (those other than coffee and oil) more competitive, and reduce the need for import controls. Under this arrangement, which involves small currency devaluations every few weeks, the regime aimed at first reducing the peso's

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overvaluation and then maintaining a favorable rate despite continuing inflation.

13. Although the initial devaluations were inadequate and subsequent ones did not fully offset price increases, nontraditional exports apparently benefited from the change, as well as from good crop conditions, new tax incentives, and the government's sales promotion efforts. As a result, these exports jumped from $111 million in 1966 to $207 million in 1969, when they made up one-third of total earnings (see Table 2). This accomplishment was in effect responsible for the 6% annual growth in total exports because the gain in coffee earnings as world prices rose was offset by a fall in oil exports. Direct controls substantially reduced imports in 1967, producing a small trade surplus. These controls were partly relaxed in 1968-69, eventually permitting imports to surpass the 1966 value, but export gains kept trade deficits at manageable levels.

Table 2

Colombia: Exports

Million US $

	1960	1966	1967	1968	1969
Coffee	334	328	322	351	344
Petroleum	80	71	61	36	57
Other	52	111	127	171	207
Total	*466*	*510*	*510*	*558*	*608*

14. The government attracted increased amounts of foreign capital by achieving greater monetary stability, which improved the investment climate and won the confidence of the International Monetary Fund and the US government. Direct private investment, which was about one-fourth greater in 1968 and 1969 than in 1966, included funds to complete Texaco-Gulf's trans-Andean oil pipeline and

start building several factories, including paper, tin can, and tire plants. Inflows of other private long-term funds increased almost three-fourths from 1966 to 1969. Assistance from the United States and international financial agencies also increased (see Table 3). Net capital receipts more than covered current account deficits in 1968-69 and, together with the 1967 import curbs, allowed foreign exchange reserves to rise from $77 million on 31 December 1966 to $264 million on 31 August 1970 (see Figure 1).

Table 3

Colombia: Foreign Aid a/

Million US $

	Annual Average 1962-66	Annual Average 1967-69
United States	88	110
World Bank	45	57
Inter-American Development Bank	16	53
Total	*141*	*220*

a. Gross receipts.

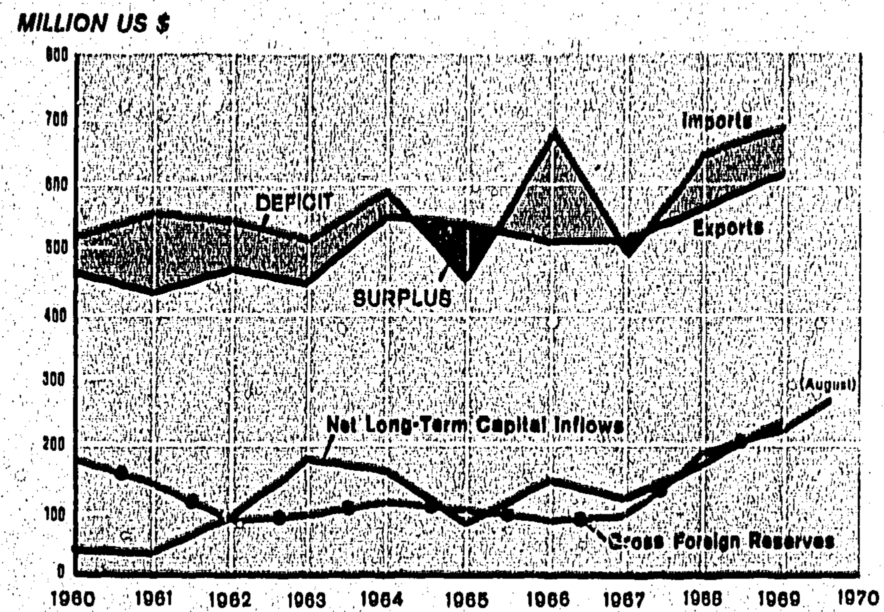
Inflation and Economic Growth

15. Efforts to check inflation yielded good but not outstanding results (see Figure 2). Annual cost-of-living increases in 1967-69 ranged from 5½% to 10%, for an average about three-fifths that of 1961-66. During January-June 1970, the cost of living rose at a 10% annual rate, the same as in 1969. Inflation rates have increased since 1968 because the government relaxed wage restraints to gain favor with organized labor.

16. Accelerated growth in agriculture, industry, and construction gave Colombia average annual

Figure 1

COLOMBIA: Balance of Payments Indicators



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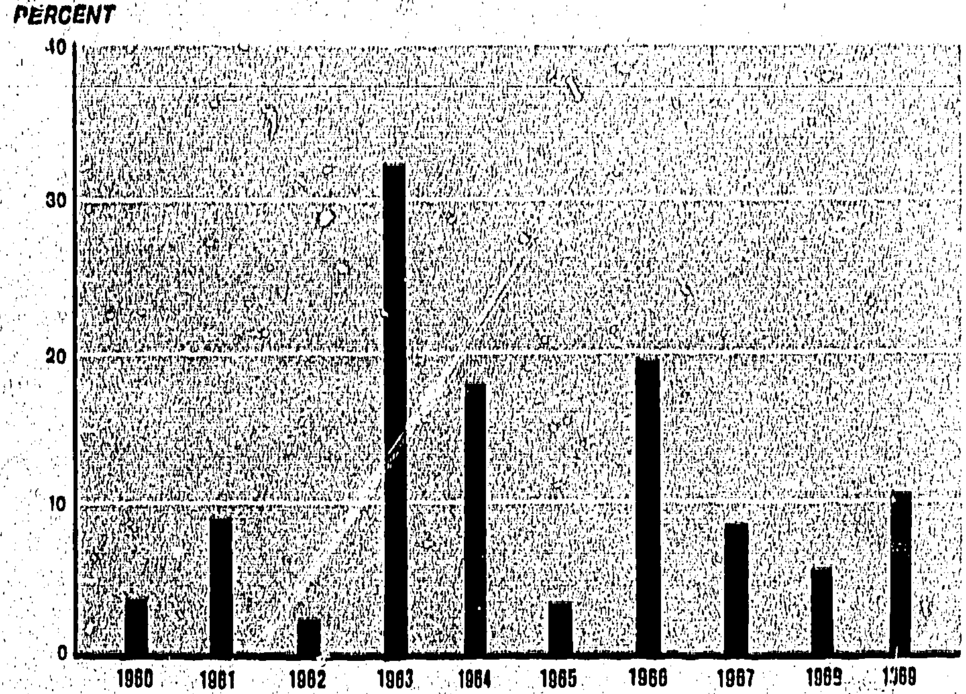
gains in GDP of 5½% in 1967-69, compared with 5% in 1961-66. Held to only 4% in 1967 because of import and exchange restrictions, the growth rate rose to 6% in 1969 and may reach 7% in 1970, for a 6% average during Lleras' term. Growth benefited from relaxing import controls as the foreign payments position improved and from a rise in the average share of fixed investment in GDP from 17% in 1961-66 to 19% in 1967-69.

Popular Welfare

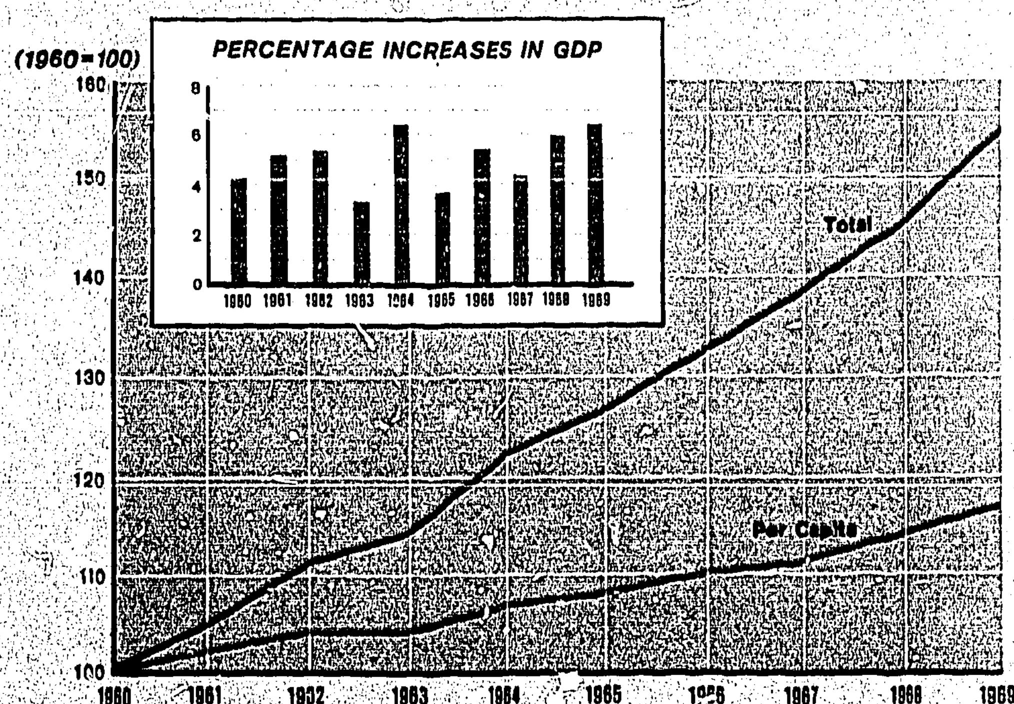
17. Although economic growth accelerated, living conditions for most Colombians did not improve as rapidly during Lleras' term as in the previous six years. During the earlier period, sluggish private investment and restrictions on government spending permitted total personal consumption to rise faster than GDP. Personal consumption per capita accordingly was able to grow an average of about 3% annually. Under Lleras, stepped-up investment and government consumption expenditure caused personal consumption to grow more slowly

Figure 2

COLOMBIA: Cost of Living Increases



COLOMBIA: Indexes of Gross Domestic Product



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than total output, holding average per capita gains to about 2% a year.

18. The Lleras government's income redistribution efforts focused almost entirely on colonization of unused land, which began in the early 1960s after passage of an agrarian reform law. Handicapped at first by inadequate resources and opposition from powerful land owners, the program got added support from the Lleras administration. Under a 1968 law the meager funds previously available to the Colombian Agrarian Reform Institute (INCORA) were supplemented with a minimum annual allocation from the central government of 300 million pesos (3½% of its total 1968 expenditure). The new law also authorized expropriation of land worked by tenant farmers and its redistribution to them. As a result, the amount of land distributed during Lleras' term rose to about 4 million acres, compared with 3½ million in the preceding five years. Under both the Valencia and Lleras administrations, unused government holdings made up more than 90% of the land distributed.

19. Although land colonization and improved income tax collection were steps forward, Colombia made little or no progress under Lleras in reducing urban unemployment. Manufacturing employment rose only 2%-3% annually, and -- except for construction -- job opportunities in other nonagricultural fields probably did not expand much faster. Rapid population growth and extensive rural-urban migration, however, increased urban labor forces at much higher rates. In Bogota, now a city of some 2½ million people, the unemployment rate has risen from 10½% to 14% since 1966. In Cali and some other cities, the rate is much higher.

<u>Outlook Under President Pastrana</u>

20. During Pastrana's term (four years ending in August 1974), Colombia seems to have little chance of achieving more than a 4½%-5% economic growth rate even if congressional obstructionism and political disturbances can be avoided. Thus prospects for more rapid improvement in living conditions are dim unless the political situation leads to excessive gains for consumers, at the cost of long-term economic development. At the same

time, it is difficult to see how the government can keep the unemployment rate from rising.

21. Although a Conservative, Pastrana promised the voters that he would continue and expand Lleras' economic reforms while looking for new ways to increase output, employment, social welfare, and foreign trade. After a colorless campaign in which he was widely regarded as Lleras' hand-picked candidate, Pastrana won a very close race with the former dictator, retired General Gustavo Rojas Pinilla, who decided to challenge the National Front arrangement. As head of the National Popular Alliance (ANAPO), Rojas ran on a platform consisting of demagogic appeals to the lower classes, with simple answers for complex problems. His promises of widespread nationalization of foreign investments, wage increases, jobs for all, and large public works programs greatly increased expectations and political awareness among the poor. Rojas' near victory -- he lost the election by only 63,000 votes (1.6% of those voting) -- dramatized the widespread discontent with the National Front's orthodox economic and social policy. Both the Conservative and Liberal parties interpret the narrowness of Pastrana's victory as a signal that more attention must be given to personal incomes, housing, schools, clinics, and agrarian reform.

22. Prospective trends in both import capacity and investment suggest that the estimated 6% economic growth rate of 1967-70 cannot be sustained. Coffee export earnings seem unlikely to rise -- and may decline -- since world coffee prices are now relatively high and export quotas under the International Coffee Agreement recently were raised. A price drop perhaps can be averted if Colombia and other major producing countries deliberately limit their shipments, but Colombian coffee revenues would not necessarily rise much as a result. Although the oil industry recently has located some encouraging geological formations, no new reserves have been discovered. Thus, oil exports probably will decline throughout the early 1970s, making Colombia a net importer by 1975.

23. Exploitation of the Cerro Matoso nickel deposits, scheduled to start in 1971, holds considerable promise but will not fully offset the

threatened drop in oil exports. By 1973, when the project is supposed to be in full production, nickel exports are expected to reach $35-$40 million, or about two-thirds as much as oil exports in 1969. If crawling peg exchange rates are retained and administered effectively, further substantial gains are likely in other exports. Their growth probably will be less rapid than in recent years, however, because of capacity limitations, competing domestic demand, and possible US and other foreign import restrictions. All in all, export growth is likely to fall below the mediocre 6% rate achieved in 1967-69. The government's ability to allow imports to rise in support of increased investment and output will, accordingly, be narrowly circumscribed.

24. Unless political instability damages the investment climate, long-term capital inflows should continue through 1974 at, or perhaps a little below, the average 1968-69 level. US aid is scheduled to drop in 1971 and seems likely to decline further in subsequent years, but increased assistance from the World Bank may offset much of the loss. Private direct investments to develop nickel, iron, and coal deposits and establish plants in such industries as chemicals and automobile assembly probably will rise somewhat, and long-term private foreign borrowing is likely to be sustained at about the average 1968-69 level. The Pastrana government has continued Lleras' active encouragement of private foreign investors, although it is insisting on larger domestic participation in new investment projects. Service payments on foreign debt are relatively low (12%-14% of expected 1970 export earnings) and are not scheduled to increase significantly during 1971-74. They thus will involve little new offset to gross capital inflows.

25. The investment rate -- now relatively high for Colombia -- seems likely to drop during 1971-74, thus contributing to slower economic growth. Although increased World Bank assistance will help to sustain public investment, private domestic investment probably will be handicapped by slow import growth. The prospective upswing in direct foreign investment nevertheless should help to prevent the investment rate from falling below the 1961-66 level. Investment prospects depend on

Pastrana's success in maintaining a favorable business climate, which in turn will be influenced by his ability to sustain recent gains in fiscal and monetary stability and to administer the crawling peg exchange rate effectively. If political instability forces Pastrana to accede to popular welfare demands that lead to financial imbalance and accelerated inflation, investment probably will drop substantially, further cutting economic growth.

Conclusions

26. Colombian economic performance improved moderately during President Lleras Restrepo's term but, for many Colombians, fell short of expectations. The thrust of policy was to mend public finances, to marshal investment resources, to broaden export possibilities, and generally to refurbish the system while avoiding disruptive reforms. Lleras' efforts were favored by substantial foreign aid inflows, rising world prices for coffee (still the dominant export), and good crop conditions. Economic growth averaged 5½% annually in 1967-69 -- one-half percentage point more than in 1961-66 and a little above the regional accomplishment. At the same time, the average inflation rate was cut from 14% in 1961-66 to 8% in 1967-69, and foreign reserves were boosted from $77 million in December 1966 to $264 million in August 1970, despite weakened oil exports.

27. Colombia's problem is that even favorable economic and political circumstances allow only slow improvement of consumer welfare. Since the population is growing about 3.2% annually, economic gains are spread thin. Although the economic growth rate rose under Lleras, the advance in personal consumption per capita slowed a bit because of emphasis on investment and government-provided services. Moreover, even the stepped-up growth of output could not create enough jobs to keep up with the expanding urban labor force. Unemployment consequently rose to 14%, or even more, of the workforce in the larger cities, where numerous rural migrants are further swelling the population.

28. Most circumstances point to slower, more vulnerable economic progress under President Pastrana than under Lleras. Export earnings are unlikely to grow as fast, especially if coffee prices are weak, new petroleum deposits are not found, and unrealistic exchange rates or foreign import restrictions seriously slow expansion of other exports. The investment rate may suffer from reduced import growth and popular clamor for prompt, perceptible gains in real income. Economic problems thus will help to put Colombia's political and social structure under considerable strain in the next few years.